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No. 06-1701

FILED
JUL 25 2007
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

SOUTHWIRE COMPANY,
Petitioner,

v.

JOHN STEPHEN JANOWICK, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF IN OPPOSITION

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INTRODUCTION

This case raises a question of contract interpretation that turns on state-law contract interpretation principles and that has arisen so infrequently as to have generated only one reported decision—that of the Sixth Circuit below. Moreover, the question is unlikely to arise in the future, because the business movement giving rise to the dispute—the wave of "demutualizations," or conversions by mutual insurance companies (owned by their policyholders) into stock companies (owned by shareholders)—began in the 1990s and long ago subsided. The question concerns the proper disposition of proceeds from a demutualization that are attributable to a "termination annuity contract"—a contract purchased from a state-licensed insurance company by a terminating pension

plan to provide the plan's former participants with monthly annuity payments that are protected by state contract law, in lieu of monthly pension payments that are protected by the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 *et seq.* More specifically, the question is whether demutualization proceeds born of such a contract should, in the absence of an express provision in the contract resolving the matter, be paid over to the annuitants who are the third-party beneficiaries of the contract, or, instead, to the employer who sponsored the pension plan before it was terminated and who is neither a party to the annuity contract nor a party responsible in any other way for guaranteeing the provision of the benefits conferred by that contract.

The Sixth Circuit—proceeding in accordance with the United States Department of Labor's opinions in this area—decided that question under state-law contract principles rather than under ERISA. Pet. App. 1a-19a. And the court of appeals decided the state-law question correctly under Kentucky law in ruling that, given the language, structure and purpose of the termination annuity contracts at issue in this case, the proper construction of the contracts was that, as between the two contestants, petitioner Southwire Company ("Southwire") and the respondent class of annuitants ("Annuitants"), the Annuitants should receive the proceeds of the demutualization. The Annuitants have the superior claim, the court reasoned, because (i) the Annuitants are third-party beneficiaries of the contract and are the only party at risk of loss in the event the insurer defaults before all of its payments are completed in the mid-21st century; and (ii) Southwire, in contrast, is neither a party to nor a beneficiary of the contracts, and is *not* at risk in the event of an insurer default, having removed itself from any responsibility to make pension payments by choosing to terminate its plan 15 years before the demutualization.

In holding that state law, rather than federal law, governs—and in resolving the state-law contract interpretation issue in

favor of the Annuitants—the Sixth Circuit reached a decision consistent with the decisions of other courts of appeals as well as with the decisions of this Court. The certiorari petition should therefore be denied.

ARGUMENT

The Sixth Circuit proceeded in two steps in deciding this case. First, the court of appeals addressed the threshold question of whether state or federal law governs "disputes over demutualization proceeds born from an annuity contract purchased to terminate an ERISA plan." Pet. App. 8a. It decided that question by adopting the position of the Department of Labor that "the terms of the relevant annuity contracts and state law" govern such disputes. *Id.* Second, the court of appeals turned to a consideration of the language of the annuity contracts at issue here and to the state-law contract interpretation principles of the pertinent state, Kentucky, and concluded that under any of three possible approaches to construing the annuity contracts under Kentucky law, the Annuitants should prevail. Pet. App. 9a-15a.[1]

1. The Sixth Circuit's decision is, in both respects, fully consistent with the decisions of other federal appeals courts and of this Court. The two court of appeals decisions that Southwire cites, *Stewart v. National Education Ass'n*, 471 F.3d 169 (D.C. Cir. 2006), and *RLJCS Enterprises, Inc. v. Professional Benefit Trust Multiple Employer Welfare Benefit Plan & Trust*, 487 F.3d 494 (7th Cir. 2007), arose in a different context and decided a different issue. In particular, in both *Stewart* and *RLJCS*, the demutualization proceeds at issue were paid over to an *ongoing* ERISA plan, and the question presented was whether the proceeds constituted plan assets

[1] This lawsuit was filed in federal district court in Kentucky as an interpleader action on the basis of diversity jurisdiction, not on the basis of federal question jurisdiction. *See* Docket, *Bank of New York v. Janowick*, Case No. 03-cv-0020 (W.D. Ky.).

that, under ERISA and the terms of the documents governing the respective ongoing plans, the plan was permitted to retain for the benefit of all plan participants. 471 F.3d at 173-76; 487 F.3d at 495-97. In contrast, in this case, no ERISA plan was in existence at the time of the 2001 demutualization because Southwire *terminated* the plan in 1986, and, in so doing, fundamentally transformed the nature of the rights and responsibilities of the parties to the plan by transferring the obligation to provide the pension benefits from the plan sponsor to a state-law regulated insurance company.

That the transformation in the nature of the parties' legal rights that occurs upon a pension plan termination is fundamental, and not trivial as Southwire suggests (Pet. 11 n.5), was confirmed by this Court just a few months ago:

> [T]erminating a plan through purchase of annuities (like terminating through distribution of lump-sum payments) formally severs the applicability of ERISA to plan assets and employer obligations. Upon purchasing annuities, the employer is no longer subject to ERISA's multitudinous requirements. . . . And the PBGC [Pension Benefit Guaranty Corporation] is likewise no longer liable for the deficiency in the event that the plan becomes insolvent; there *are* no more benefits for it to guarantee. *The assets of the plan are wholly removed from the ERISA system*, and plan participants and beneficiaries must rely primarily (if not exclusively) on state-contract remedies if they do not receive proper payments or are otherwise denied access to their funds. Further, from the standpoint of the participants and beneficiaries, the risk associated with an annuity relates solely to the solvency of an insurance company, and not the performance of [a] . . . plan's investments.

Beck v. PACE Int'l Union, 551 U.S. __, 127 S. Ct. 2310, 2318-19 (2007) (first emphasis in original, second emphasis added).

In its decision below, the Sixth Circuit recognized the transformative effect of a plan termination in distinguishing this case from ongoing-plan cases. Pet. App. 16a-17a. In drawing that distinction, the court of appeals followed the analysis of the Department of Labor (DOL), expressed in two complementary opinions, the first issued in 2001, U.S. Dep't. of Labor, Pension & Welfare Benefit Programs Opinion No. 2001-02A (Feb. 15, 2001), 2001 WL 429857, and the second in 2003, DOL Opinion No. 2003-05A (Apr. 10, 2003), 2003 WL 1901900.

In the 2001 opinion, the Department concluded, as did the courts of appeal in *Stewart* and *RLJCS*, that in the case of annuity contracts held by *ongoing* plans, ERISA and the terms of the plan govern the disposition of any demutualization proceeds emanating from the contracts, because those proceeds are plan assets. 2001 WL 429857, at *2 n.2.

In the 2003 opinion—the opinion addressing the situation in this case involving a *terminated* plan—the Department concluded that the disposition of demutualization proceeds "is governed by the terms of the contract and applicable state law," and *not* by ERISA. 2003 WL 1901900, at *3. The Department reached that result after stating that proceeds generated by reason of an insurance company's demutualization that post-dates the termination of an ERISA plan are not ERISA "plan assets," 2003 WL 1901900, at *2-3—a statement that accords with this Court's later statement in *Beck v. PACE*, quoted above, that upon plan termination "[t]he assets of the plan are wholly removed from the ERISA system," 127 S. Ct. at 2318.

Once the distinction between the legal regime governing ongoing plans and the regime governing terminated plans is recognized, it becomes clear that the D.C. Circuit's decision in *Stewart* and the Seventh Circuit's decision in *RLJCS* not only present no conflict with the Sixth Circuit's decision in this case, but in fact complement that decision in the same

way that the two DOL opinions complement one another. In *Stewart* and in *RLJCS*, the plan at issue was an ongoing plan, not a terminated one, and the respective courts of appeal, consistent with the analysis set forth in the DOL's *2001* opinion concerning ongoing plans, looked to ERISA principles and the terms of the plan in resolving the disputes over demutualization proceeds. 471 F.3d at 173-76; 487 F.3d at 495-97. Here, the plan was terminated, and the Sixth Circuit, consistent with the DOL's *2003* opinion, looked to state law and the terms of the contract in resolving the dispute.

Given the clarity of the distinction between the issue the Sixth Circuit decided in this case and the issue the D.C. and Seventh Circuits decided in the *Stewart* and *RLJCS* cases, Petitioner's contention that there is a "deepening conflict among the Federal Courts of Appeals" (Pet. 1) is fanciful to say the least. Indeed, as Petitioner is forced to acknowledge in a footnote concession, "[t]he D.C. Circuit in *Stewart* distinguished the Sixth Circuit's majority opinion . . . noting that the group life insurance plan was *ongoing*." Pet. 11 n.5 (emphasis added). That concession reveals that Petitioner itself cannot be not serious in claiming that there is a genuine circuit conflict.

2. The Sixth Circuit's opinion is not only consistent with the decisions of other courts of appeal, it is correct on the merits; and it is not remotely an opinion that "decide[s] an important federal question in a way that conflicts with relevant decisions of this Court." Supreme Court Rule 10(a), so as to warrant review by this Court in the absence of a circuit conflict.

a. As we have noted, the Sixth Circuit here properly recognized that the second of the Department of Labor's two opinions concerning demutualization—the 2003 opinion—spoke to the issue presented in this case, and the court of appeals adopted the DOL's position that state law and the terms of the annuity contract control the disposition of de-

mutualization proceeds born of an annuity contract purchased to effectuate a plan termination. Pet. App. 8a.

The Petitioner does not even mention the 2003 DOL opinion in its certiorari petition, much less mount an argument that that opinion is unsound or unworthy of respect. That is because the Department of Labor's conclusion that state law and the terms of the annuity contract govern the disposition of post-termination demutualization proceeds is unassailable.

The Department's conclusion follows ineluctably from the fact—recognized by this Court in the block-quoted passage from *Beck v. PACE* set forth *supra* at 4—that the termination of an ERISA plan through the purchase of annuity contracts works a transformation in the rights and responsibilities of the parties to the plan, because it transfers the obligation to provide the pension benefits from the ERISA-regulated plan sponsor to a state-law regulated insurance company. *See Beck*, 127 S. Ct. at 2318-19.

Termination of an ERISA plan through the purchase of an annuity contract is therefore akin to a contract novation, whereby the insurance company/annuity provider becomes the new obligor pursuant to a new legal instrument (the annuity contract), which substitutes for the original legal instrument (the ERISA plan), releasing the original obligor (the plan sponsor) from legal liability. *See* 30 Williston on Contracts § 76:1 (4th ed. 1990). After the pension plan's termination, pension benefits are paid by the annuity provider pursuant to the terms of the annuity contract rather than by the plan pursuant to the terms of the plan's trust documents. And, the annuity contract is not an ERISA plan and is not governed by ERISA provisions; rather, it is an insurance contract governed in all its aspects by state contract and insurance law.

As the PBGC has explained and the courts have held, after a plan termination, if the annuity provider defaults and fails to

make the required monthly retirement payments to the former participants, the terminated plan is not "revive[d]," and the former plan's sponsor has no liability to the shortchanged former participants; the former participants' remedy is a state-law contract action under the annuity contract. *See Waller v. Blue Cross of Cal.*, 32 F.3d 1337, 1344-45 (9th Cir. 1994); PBGC Opinion Letter 91-4 (May 3, 1991), 1991 WL 80735, at *1 (concluding that where an ERISA pension plan was terminated properly and the insurer later became insolvent, the "former plan sponsors of the terminated plans would have no liability, under Title IV of ERISA, for plan benefits"); 29 C.F.R. §4041.28(d)(2); *see also Beck*, 127 S. Ct. at 2318-19.[2]

Because it is the state-law-governed annuity contract—and not the terminated ERISA-governed pension plan—that protects the beneficiaries' legal right to their pension benefits, the Department of Labor was therefore correct in concluding in its 2003 opinion that state contract law, rather than ERISA, governs disputes over the ownership of demutualization proceeds arising from termination annuity contracts. And the

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[2] The only other recourse possibly available to shortchanged former plan participants is a breach-of-fiduciary suit against the plan fiduciary who selected the annuity provider, but such a lawsuit is no substitute for plan benefits. That type of lawsuit cannot succeed where, at the time of the annuity purchase, the insurer appeared to be a financially sound and prudent choice of annuity provider, *see Waller*, 32 F.3d at 1344-45; and, because termination annuity contracts typically involve commitments to pay out funds over a period of decades, apparent financial soundness at the time of contract purchase is no guarantee of long-term financial soundness, as a spate of insurer insolvencies in the late 1980s demonstrates. *See* General Accounting Office Report No. 93-29, Private Pensions: Protections for Retirees' Insurance Annuities Can Be Strengthened (Mar. 1993) (documenting numerous insurer insolvencies). For these reasons, the Court in *Beck v. PACE* remarked that, after plan termination, no ERISA claim for benefits can be brought against the plan or its sponsor, and "plan participants and beneficiaries must rely primarily (if not exclusively) on state-contract remedies if they do not receive proper payments or are otherwise denied access to their funds." 127 S. Ct. at 2318.

Sixth Circuit was therefore right to follow the 2003 opinion's analysis and to distinguish this case from ongoing-plan cases governed by the DOL's 2001 opinion. *See* Pet. App. 8a, 16a; DOL Opinion, 2003 WL 1901900, at *3.[3]

b. It follows from the foregoing that there is no merit whatsoever to the Petitioner's contention that the Sixth Circuit's key ruling here—that state law and the terms of the annuity contract control—"'is foreclosed' by this Court's decision [construing ERISA] in *Hughes Aircraft* [*Co. v. Jacobson*, 525 U.S. 432 (1999)]." Pet. 10-11.

Hughes Aircraft, like the two circuit court cases that Petitioner invokes in support of its meritless claim of a circuit split, presented a question pertaining to the administration of an *ongoing* ERISA plan—there an ongoing ERISA "defined benefit" pension plan.[4] *Hughes Aircraft* did not even address,

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[3] Because state law governs upon plan termination, ERISA does not confer on *either* a former plan participant *or* a former plan sponsor a federal right to demutualization proceeds stemming from a termination annuity contract. Thus, the syllogism underlying the opinion of the dissenting judge below—that this case should be decided against the Annuitants because *ERISA* does not confer on them any right to the proceeds—begs the question. For it could be asserted with equal logic (or, rather, illogic) that this case should be decided against Southwire, because ERISA does not confer on *Southwire* any right to the proceeds. The reason that neither syllogism is satisfactory is that both exclude the possibility that state law, and *not* ERISA, governs post-termination, and both syllogisms therefore elide, rather than aid in answering, the fundamental question presented in this case.

[4] A "defined benefit" pension plan is one that promises participants that, upon retirement, they will receive a fixed level of benefits based on a formula (such as 50% of the average of their final three years' salary) that is independent of the performance of the plan's investments. In contrast, a "defined contribution" plan, such as the familiar "401(k) plan," provides each participant with a separate dedicated account to which periodic contributions are made during their career, and it promises each participant only that, on retirement, she will be entitled to those funds and the pro-

let alone resolve in Southwire's favor, the question as to whether, after a plan terminates, federal law continues to govern the relationships between and among the annuitants, the annuity provider, and the former plan's sponsor. On that matter, the only relevant authorities are this Court's recent decision in *Beck v. PACE*—which, as noted, states that "[t]erminating a plan through purchase of annuities . . . formally severs the applicability of ERISA to plan assets" such that "the assets of the plan are wholly removed from the ERISA system"—and the DOL's 2003 opinion, which reaches the same conclusion and provides that state law governs the relevant relationships upon plan termination.

Thus, as the Sixth Circuit observed, because the controversy here does not involve a dispute concerning the assets of an ongoing ERISA plan, but rather a distinctly different dispute that arises in a distinctly different factual and legal setting—*viz*, a dispute concerning proceeds that arise from annuity contracts governed by state law rather than by ERISA—"[*Hughes Aircraft v.*] *Jacobson* in no way forecloses the Employees' claim to the demutualization proceeds." Pet. App. 14a n.6.

Furthermore, Petitioner completely misreads *Hughes Aircraft* when it attempts to draw from the Court's observation that *ongoing* defined-benefit plans are characterized by "employer . . . investment risk" and a concomitant "employer[] obligation to make up any shortfall," 525 U.S. at 439-40, the inference that ERISA would entitle employers—*after* terminating a plan and hence *after* ridding themselves of any "obligation to make up any shortfall" in the event the insurance company annuity provider defaults—to reap the benefit of any and all unexpected proceeds generated by state-law governed termination annuity contracts.

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ceeds they generate. *See Hughes Aircraft*, 525 U.S. at 439; *see also infra* at 11-12.

The attempt to draw that inference fails at its inception, because the opinion in *Hughes Aircraft* expressly qualifies the very observations on which Petitioner relies concerning "employer . . . risk" and "employer[] obligation" by stating that those observations apply only "*short of the consequences of plan termination.*" 525 U.S. at 439-40 (emphasis added). Indeed by qualifying its observations in that manner, the *Hughes Aircraft* opinion indicates that, *upon* plan termination, the employer *sheds* the investment risk and accompanying ERISA obligation to cover any shortfall attendant to maintaining an ongoing defined-benefit plan. And, in that regard, the *Hughes Aircraft* opinion presages the Court's fuller statement of the same point in *Beck v. PACE*, where, as we have stressed, the Court explained that "[t]erminating a plan through purchase of annuities (like terminating through distribution of lump-sum payments) formally severs the applicability of ERISA to plan assets *and employer obligations*." 127 S. Ct. at 2318 (emphasis added).

c. While the foregoing is more than sufficient to rebut Southwire's claim that the Sixth Circuit's decision is "foreclosed by" *Hughes Aircraft*, we would also note that Southwire not only has overlooked the express qualifying language in *Hughes Aircraft* just discussed, but has missed the broader lesson of *Hughes Aircraft* as well.

Hughes Aircraft involved a claim by certain plan participants to a portion of the "surplus" assets in an ERISA defined-benefit plan; their claim was that the employer-sponsor used "their" portion of the surplus to create a new benefit structure that would only benefit other participants, who had not contributed to the growth of the surplus.

The Court, in rejecting the claim, began by stating that "it is essential to recognize the difference between defined contribution plans and defined benefit plans" in order "[t]o understand why respondents have no interest in the Plan's surplus." 525 U.S. at 439. That is so, the Court explained,

because the two types of plans differ in how the risk of loss is allocated. Employee-participants in a defined contribution plan bear the risk of poor performance of the investments assigned to their accounts, but they also reap the benefit of good performance, so that their income upon retirement will depend on the performance of the particular investments. *Id.* In contrast, in a defined benefit plan, all of the plan's investments are in one general pool of assets, the employer-sponsor bears the entire investment risk, and any shortfall in funding due to a decline in the value of plan assets must be covered by the employer out of its own pocket and not through a reduction in plan members' accrued benefits. *Id.* at 439-40. Participants in an ongoing defined-benefit plan are thus insulated from investment-performance risk, while the employer is fully exposed to that risk.

After setting out those background points, the *Hughes Aircraft* Court then rejected the claim of the plaintiff-participants there to a portion of the ongoing plan's surplus, reasoning that, "[s]ince a decline in the value of the plan's assets does not alter [plan members'] accrued benefits, members similarly have no entitlement to share in a plan's surplus." *Id.* at 440.

Thus if there is lesson of *Hughes Aircraft* that is relevant to this case, the lesson is that upside gain should be aligned with downside risk, and that, as a rule, the party that bears the risk in connection with a contract has a superior claim to "excess" investment gains than a party bearing no risk. Applying that lesson to the instant context, the reasoning of *Hughes Aircraft*—though not of course binding of its own force with regard to a state-law contract interpretation question—supports the Sixth Circuit's decision in favor of the Annuitants here, because the court of appeals undertook the Kentucky-law task of filling in the gap in the annuity contracts regarding the disposition of demutualization proceeds by assigning those proceeds to the parties that remained at risk,

the Annuitants, rather than to a party bearing no risk, Southwire. Pet. App. 13a-14a. *Cf. RLJCS Enters.*, 487 F.3d at 495, 495-97 (reasoning that, because under the *ongoing* ERISA welfare benefit plan at issue there, "the employees are assured of coverage even if a particular insurer should fail, [and] all assets of the [plan] stand behind every promised benefit," the plan was entitled to demutualization proceeds arising from the insurance policies held by the plan, and the individual insureds, who were insulated from the risk of an insurance company failure, were not so entitled).

3. Aside from claiming, erroneously as we have shown, that the Sixth Circuit's decision is in conflict with the decisions of other courts of appeal and with *Hughes Aircraft*, Southwire also suggests at various points that the Sixth Circuit erred in its construction of the annuity contracts under Kentucky law by, *inter alia*, misreading the "contract-holder" language in those contracts. Pet. 10-11, 20, 22-23.

Southwire's passing suggestions would not raise a matter worthy of this Court's attention even if, contrary to fact, those suggestions had potential substance. The purpose of this Court's certiorari review power is to resolve significant *federal* questions, as to which this Court is in a unique position to make final determinations that ensure uniformity across the federal system. This Court does not sit to pass on questions of state law, as to which state supreme courts possess final authority, much less does it sit to parse contract provisions under state-law interpretation principles.

The only *federal* question the Sixth Circuit decided was the threshold choice-of-law question itself, *viz.* whether the disposition of demutualization proceeds born of an annuity contract purchased to terminate an ERISA plan is governed by federal law and the terms of the defunct plan, or, as the DOL has concluded, by state law and the terms of the annuity contract. And, as we have shown, the Sixth Circuit's analysis

was not only consistent with that of other circuits and this Court, it was entirely correct.[5]

4. One final point merits discussion. The question presented in this case is an exceedingly narrow one highly unlikely to arise in the future with the frequency that could justify this Court's attention. This case is the only reported case involving the payment of unexpected demutualization proceeds arising from an annuity contract purchased by a terminating pension plan and paid out pursuant to an insurance contract that did not provide for the contingency of demutualization, and we are aware of only a handful of other instances where this has occurred. Further, as the Sixth Circuit's opinion notes, the termination annuity contracts here were purchased in 1986, before New Jersey and other states enacted laws in the 1990s repealing prohibitions on the conversion of mutual insurance companies to stock companies. Pet. App. 3a, 5a. Contracts and other legal instruments drafted after that legislative development are more likely to

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[5] At the risk of overkill, we would note that, even were one to indulge Southwire's view that federal law and the terms of the defunct plan govern the disposition of the demutualization proceeds here, this case *still* would not be fit for review by this Court. That is because the Sixth Circuit examined the plan provision that Southwire claimed entitled it to the demutualization proceeds, and the court concluded that Southwire had misconstrued the provision's language. Pet. App. 17a. In particular, the Sixth Circuit held that the provision in question did not state, as Southwire claims (Pet. 23), that funds coming into existence *after* plan termination (such as the demutualization proceeds here) revert to the plan sponsor; rather, the provision stated only that funds already held by the plan *prior* to termination so revert. Pet. App. 17a. This Court's attention and resources are not wisely expended on the review of case-specific determinations by lower courts as to the proper construction of a particular plan or trust document. And yet that is precisely what this Court would have to do if it were to agree with Southwire's dubious argument that the disposition of the proceeds here turns on federal law and the construction of the plan document, rather than on state law.

deal with the contingency in express terms, precluding disputes like the instant one.

Moreover, in the wake of those laws, the nation's mutual insurance companies decided promptly one way or the other whether to demutualize, and hence the wave of demutualizations that crested in the late 1990s had subsided by 2002. *See* Insurance Times: "Wave of Demutualizations by Life Insurers Subsides," October 15, 2002, Vol. XXI No. 21 (explaining that by 2002 all of the major mutual insurance companies had made their decision as to whether to demutualize). Thus, in addition to the other reasons for denying the certiorari petition, this case is not one of sufficient general importance to warrant this Court's attention.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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